DECODING COMPANIES (AUDITOR'S REPORT) ORDER, 2020

Kevin Vora
Email : kevinvora@shahmodi.com

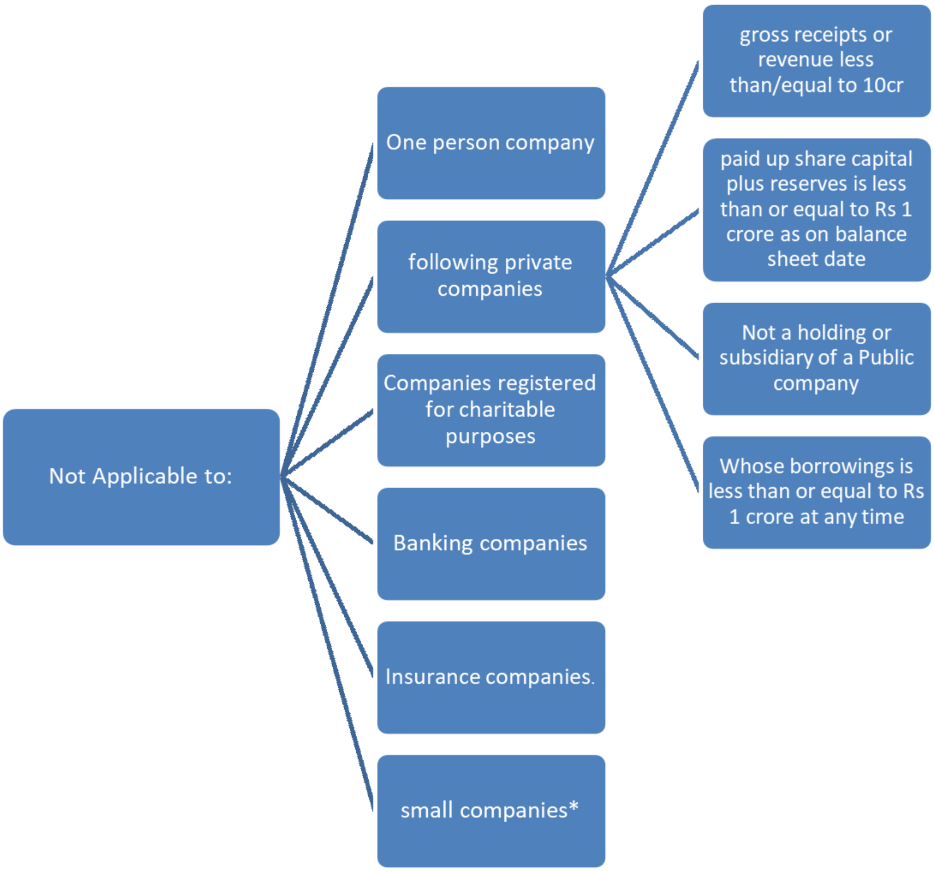
Introduction:

The Companies (Auditor's Report) Order, 2020, commonly known as CARO 2020, is a regulatory framework in India that mandates specific reporting requirements for auditors while conducting an audit of a company's financial statements. The Ministry of Corporate Affairs (MCA) issued CARO 2020 on 25th February 2020. CARO 2020 was initially applicable for audits of financial year 2019-20 onwards. Subsequently its applicability was deferred two times vide notification dated 24th March 2020 and 17th December 2020.

This order was issued by the Ministry of Corporate Affairs (MCA) to enhance transparency, accountability, and the quality of financial reporting in companies. CARO 2020 supersedes the previous CARO 2016 and introduces several new reporting requirements to ensure a more comprehensive audit process. CARO 2020 contains several significant changes and new reporting requirements vis-à-vis CARO 2016.

Applicability:

CARO 2020 is applicable for all statutory audits commencing on or after 1 April 2020 corresponding to the financial year 2019-20. The order is applicable to all companies which were covered by CARO 2016 including foreign companies. It does not apply to following:



* It may be noted that in case company is covered under the definition of small company, it will remain exempted from the applicability of CARO 2020 even if it falls under any criteria specified for private company.

A private limited company in order to be exempt from the applicability of the order, must satisfy all the conditions mentioned above collectively. In other words, even if one of conditions is not satisfied, the order would be applicable to the company.

Further CARO 2020 shall not apply to the auditor's report on the consolidated financial statements (CFS) except that qualification / adverse remarks in CARO in the audit report of the components which are consolidated in the CFS will be required to be reported.

Key reporting Requirements under CARO 2020 and changes vis-à-vis CARO 2016:

CARO 2020 has in all total 21 clauses. Total 7 new clauses have been added, there is no change in 6 clauses, the scope of reporting is expanded in 8 clauses and 1 clause is deleted.

Let's now understand some of key and important changes in CARO 2020 vis-à-vis CARO 2016:

Clause reference	Key changes
Clause 3(i) – Property, Plant, Equipment	• Words "**Fixed Assets**" is replaced with "**Property Plant & Equipment**". This is done to align with AS-10 • Disclosure regarding title deeds of **immovable property** is now to be given as per format specified. • One has also to report about whether **revaluation** of assets done by registered valuer and whether such valuation exceeds 10% of aggregate net carrying value of each class of assets. • Reporting relating to whether proceedings have been initiated in respect of "Benami Transactions" is to be done.

Clause reference	Key changes
Clause 3(ii) – Inventory	• Materiality of 10% has been specified in order to remove ambiguity of discrepancy of changes mentioned in audit report. So, if change in inventory exceeds 10% or more, disclosure regarding same is to be given. • Disclosure for working capital limit of Rs. 5 crore or more at any point of time during year is to be given. Also whether quarterly returns of statement filed by company with bank or financial institutions are in agreement with books of accounts or not is to be disclosed.
Clause 3(iii) – Loan, Investments, guarantee, securities and advances in nature of loan	• The words loan given to the parties u/s 189 is removed and loan given to any person is now included. • Words "investment, guarantees and security" have been added. • Disclosure of loan extended, renewed or fresh loan granted has been settled against overdue of existing loan. • Whether any loans are repayable on demand or without specifying any terms of repayment. By making above changes the disclosure requirement has been enhanced made by adding the word 'Investment, Guarantees & Security and by removing the word 'parties covered u/s 189. Further, true picture of financials will be shown by disclosing the loan extended or fresh loan settled against overdue loan.
Clause 3(v) – Deposits	• The scope of reporting of deposits is extended by adding the words "deemed to be deposits".
Clause 3(viii) – Unrecorded Income	• This clause seeks to match books of accounts with the tax assessments made in respect of unrecorded incomes. New clause was being inserted, in case any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961, if so, whether the previously unrecorded income has been properly recorded in the books of account during the year.
Clause 3(ix) – Borrowings	• The reporting scope has been enhanced by adding the word payment of interest on borrowing from any lender in place of banks, financial institutions, government dues or debenture holders. • If company is declared wilful defaulter the same is also to be disclosed. • Disclosure also has to be made if funds are raised by company to meet obligations of its subsidiaries, associates or joint ventures.
Clause 3(xi) – Fraud	• The scope of fraud reporting has also been increased. Disclosure in case of any report has been filed in Form ADT-4 under section 143(12) by the auditors with the central government is to be done. • Whistle blower complaints if any received are also to be disclosed.

Clause reference	Key changes
Clause 3(xiv) – Internal Audit	• This is new clause that is being inserted. Reporting under this clause focusses on role of internal auditor and expresses responsibility of statutory auditor to rely on work of internal audit report. • Company has to report whether internal audit system is commensurate to size and nature of business of company. • Also disclosure is to be made for whether report of internal auditor is being considered by statutory auditor or not.
Clause 3(xvii) – Cash Losses	• New clause inserted to disclose cash losses incurred during financial year and also in immediately preceding financial year.
Clause 3(xviii) – Resignation of Auditor	• This clause is inserted to disclose issues, objections or concerns raised by outgoing auditor at the time of resignation as statutory auditor during the year.
Clause 3(xix) – Financial Capability of the company	• Again this is a new clause and it requires disclosure of whether the company is capable to meet out its liabilities that existing on the balance sheet date as and when they fall due within one year. Auditor needs to analysis on the basis of financial ratio, ageing of financial assets and financial liabilities and Expected realization of those assets and liabilities.
Clause 3(xx) – CSR compliances	• To check compliance with second proviso to sub-section (5) of section 135 & sub-section (6) of section 135 of the Companies Act, 2013 this clause is inserted. • Disclosure has to be done of whether company has transferred unspent CSR amount in case of outgoing projects to a special designated bank account and for other than outgoing projects to a fund specified under Schedule VII to the companies act within 6 months period of the expiry of financial year.
Clause 3(xxi) – Consolidated financial statement	• New clause was being inserted, to disclose any qualifications or adverse remarks by the auditor in their reports of the companies (subsidiary) should be included in the consolidated financial statements (Parent).

Conclusion:

The introduction of CARO 2020 was triggered by a number of corporate failures (especially IL&FS) and a whole boost of exposure to corporate frauds as witnessed under IBC, which has triggered CARO 2020. It entails to bring upon more accountability, corporate trusteeship, and transparency. A different feature of CARO 2020 is the enhanced due diligence responsibility on the auditors. CARO 2020 covers many governance issues on which the MCA requires the auditors to comment.